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OFFICE OF THE GOVERNOR
Budget and Program Planning

A REVIEW OF THE
PRIORITY BUDGETING SYSTEM

Thomas L. Judge, Governor
Michael G. Billings, Director

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STATE OF MONTANA

PRIORITY BUDGETING SYSTEM

1977 - 1979 Biennium

BUDGET PRESENTATION

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Budget and Program Planning

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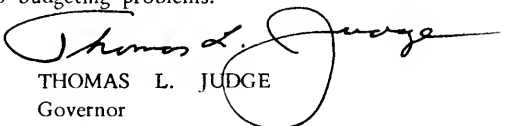
MEMBERS OF THE FORTY-FIFTH LEGISLATIVE ASSEMBLY:

I am pleased to include in the 1977-79 biennial Executive Budget a "program planning and budgeting system," in accordance with House Bill 643. Seven programs in Montana State government were selected as pilots to provide a detailed analysis and justification of budget requests to enable decision makers to identify, evaluate, and rank in order of importance activities in a program. We call this new budget procedure the "Priority Budgeting System." It includes many of the new budgetary reform concepts such as zero-based budgeting.

I considered this, along with other planned improvements in the budget preparation process, to be an undertaking that will assist all of us in reevaluating government operations and resource needs. I feel the process will encourage and stimulate imagination in providing better and/or less expensive methods of government operations.

The end result can provide a more in-depth understanding of the manner in which our financial resources are utilized in the operations of state government in Montana on the part of everyone concerned — the executive branch, the Legislature, and most importantly, the citizens of our state.

In reviewing the Priority Budget presentation, I would like to remind you that a new budgeting system is not introduced overnight. Budget reform and improvement often takes years to develop. Therefore, do not herald the Priority Budgeting System as a new messiah that will bring about immediate solutions to budgeting problems.


THOMAS L. JUDGE
Governor

INTRODUCTION

House Bill 643 (Chapter 460, Montana Session Laws of 1975) provides that the "budget director shall implement a program planning and budgeting system . . . for at least one program in representative agencies of state government such as planning, human services delivery, licensing and regulation, and other programs as determined by the budget director."

The Office of Budget and Program Planning (OBPP) responded to the requirements of House Bill 643 with a process termed the Priority Budgeting System. The basic concept of the Priority Budgeting System is that the estimate of financial needs for a budget program must be justified and analyzed in its entirety. Under this system, programs are required to biennially assess the benefit derived from ongoing operations, as well as the need for additional resources. The Priority Budgeting System identifies to all levels of management the cost, benefits, and suggested operational improvement associated with the achievement of desired goals and objectives.

In brief, the process begins with the identification of all the discrete activities within a program. The budget request for each activity is developed in a series of "activity decision packages," each one representing the resources required to support a particular output and impact at each of the levels which the activity might operate if the funding request were ultimately approved.*

Decision packages are then ranked in order of priority by each agency in presenting its budget request to the executive branch. The ranking process offers each decision maker the opportunity to fully express his recommendations for the allocation of resources within that particular agency. The agency recommendations are then evaluated by the Office of Budget and Program Planning in cooperation with program personnel.

* Instructions and procedures for the Priority Budgeting System and a complete set of examples can be obtained in the Office of Budget and Program Planning.

GLOSSARY

Budget Program Structure

1. Functional area: each area represents a major purpose of state government. The seven functional areas which have been identified for current state operations include Education, Human Services, Economy and the Environment, Community Affairs, Public Safety, Transportation, and General Government.
2. Program: the logical grouping of a set of activities directed to a common purpose. Programs are grouped within functional areas such as Physical Health, Mental Health, Deaf and Blind Services, etc., under Human Services.
3. Sub-program: the basic component of a program, the sub-program, is the third level of detail and should reflect efforts necessary to achieve stated goals. Examples would be Centralized Services, Weights and Measures, Financial, Milk Control and Consumer Protection within Business Regulation.
4. Activity: a discrete function or operation designed to achieve a specific objective through work outputs which have a measurable policy effect.

Note: Budget program structure does not necessarily parallel organizational program structure. The activity is the basic building block which should relate to either the budget or operating structure.

Objective

A statement of planned result, quantifiable within a specific time frame.

Workload and/or Demand Estimator

The original impetus (citizens, legislation, natural causes) for directing resources to achieve desired results, (i.e., the number of persons served by a program or the level of activities being undertaken).

Output Measure

An accountable unit of work at the activity level which measures the extent of that activity. (The term substitutes for "Program size indicator" in H.B. 643.)

Effectiveness Indicator

An indication of the effect that programs/sub-programs have upon individuals or the environment.

Current Level Services

The level of effort authorized by a program's 1977 fiscal year appropriation plus inescapable increases due to salary adjustments and inflation. (Activities authorized through budget amendment are not part of current level services but are considered as a modification of current level services and are considered at a level of funding above current level.)

Activity Decision Package

A means of analyzing and grouping the use of resources by discrete operational units within a program using performance measures for evaluation. Analysis of the relationship of outputs and inputs to different funding levels is used to compare and then rank the decision packages in a manner which will ensure the greatest possible benefit.

Zero-Base Budgeting

A system whereby each governmental program, regardless of whether it is new or an existing program, must be justified in its entirety each budgeting cycle. This approach requires that programs and activities are organized and budgeted in a detailed plan which focuses review, evaluation and analysis on all proposed expenditures rather than on increases above current expenditure levels. The purpose is to determine whether each activity warrants continuation at current level or a different level, or should be terminated.

Some of the main features of zero-base budgeting include activity or program decision packages, various alternative funding levels, a priority ranking of the decision packages, and the zero-base review and evaluation of such programs or activities.

THE PRIORITY BUDGETING SYSTEM: PURPOSE AND CONCEPTS

Purpose

In most cases, plans and budgets are typically developed by taking the cost of the current level of operation, adding "built-in" and inescapable adjustments such as salary increases, and then requesting additional expenditures and programs. This process does not require a detailed review of the ongoing operations and expenditure levels, has led to ever-increasing budgets, and places the burden of proof on the executive and legislative review process to alter these budget requests.

For the 1977-79 budget, a system is being introduced which requires each pilot agency to justify its entire budget request in detail, and shifts the burden of proof to each agency to justify why any money should be spent. This procedure requires that all activities and operations be identified in "activity decision packages," which are evaluated and ranked in order of importance by systematic analysis. (Activity decision packages are so named because they require thorough analysis of the costs and benefits of completing a discrete activity and because the information generated as a result of such a process encourages a more rational decision on the desirability of carrying out the activity and, if so, at the most appropriate level of effort.)

This approach can provide numerous benefits. First of all, the identification of one hundred percent of each activity requires each manager to carefully evaluate and consider the ongoing need for each activity and to consider different levels of effort and alternative ways for performing the activity. Secondly, based on the evaluation of alternatives, the agency has the opportunity to communicate its analysis and recommendations to the executive branch for review and consideration in determining budget allocations. Third, once activity decision packages are identified, prepared and accorded a priority ranking, changes in desired expenditure levels for program budgets do not require recycling of budget inputs, but the decision package ranking identifies those activities (decision packages) to be added or deleted. Finally, the list of ranked decision packages can be used during the operating year to identify activities to be reduced or expanded if allowable expenditure levels change or actual costs vary from the budget.

The goals of the Priority Budgeting System are to encourage "results management" and to place more emphasis on outputs and impacts of programs. By shifting focus from strictly inputs to outputs and impacts - - inputs (dollars and people) are then examined in terms of their use in producing the desired outcomes of a program. In addition, the Priority Budgeting System promotes increased accountability of agencies. Tying projected and realized results to variance reporting will promote needed accountability in state government. Achieving these goals will improve executive and legislative decision making and lead to improved government operations.

Concept of the Priority Budgeting System

The activity decision packages are the building blocks of the Priority Budgeting System. An activity decision package identifies a discrete function or operation in a definite manner for evaluation and comparison with other functions, including consequences of not performing that function, alternative courses of action, and costs and benefits. Activity decision packages are defined at operating levels below the program level in most departments where discrete activities of an operation can have meaningful identification and evaluation.

Formulating activity decision packages at a level below the program level promotes identification of activities, operations, and alternatives by those most familiar with the task performed, as well as generating interest in and commitment by individuals who are responsible for carrying out the actions identified in the approved packages.

The identification of "business as usual" (or current) levels of effort provides the basis from which agencies consider operating requirements for the ensuing biennium. The real starting point in determining the biennial budget occurs when alternatives to "current" levels of effort are developed by evaluating different ways and/or levels of effort to perform the activity.

There are two types of alternatives that are considered when developing the decision packages:

1. Alternative methods of performing the same activity (i.e., contracted services or an entirely new approach).
2. Alternative levels of effort of performing the same activity. A minimum level of effort is established (80 percent or less of the current biennium appropriation) and additional levels of effort are identified as separate decision packages. The minimum level of effort may not completely achieve the purpose of the activity (even additional levels of effort proposed may not completely achieve it because of realistic budget and achievement constraints), but it should identify and attack the most important elements.

At the conclusion of the formulation stage of the activity decision packages, each agency has identified the proposed functions of its operation and the various alternative levels and/or methods of operation.

Activity Decision Package Ranking

Once activity decision packages are formulated, agencies rank all their packages in a priority order of importance. The ranking process attempts to provide management with a technique to allocate its limited resources by answering the questions: What objectives should agencies attempt to achieve? How much should be spent in the attempt?

Agencies answer these questions by taking the decision packages identified and listing (ranking) them in order of decreasing benefit. Agencies identify both the benefits to be gained at each expenditure level and the consequences of not approving additional packages ranked below that expenditure level.

Activity Decision Package Ranking (cont'd)

The initial ranking of activity decision packages occurs at the agency level where the packages are developed to allow each manager to evaluate the relative importance of the various activities involved. The ranking is reviewed at the executive level and used as a guide in making the final determination and recommendation of activity decision packages for budget presentation. Ranking the activity decision packages allows decision makers to evaluate the desirability of various expenditure levels as it impacts on the activities of an agency.

Conclusion

It is important to note that the basic thrust of this approach to planning and budgeting is to refocus attention on the outputs (work accomplished) and impacts (effectiveness) of a program's efforts, thus enabling a clearer understanding of the way inputs (resources in dollars and personnel) are managed to achieve those results. In fact, the relationship between inputs and outputs is the basis for evaluating efficiency (or productivity); the relationship between inputs and impacts establishes the basis for judging effectiveness. Thus, the Priority Budgeting System builds upon the strengths of the traditional input approach to budgeting by providing program and fiscal managers, as well as executive and legislative decision makers, with a much more concrete assessment of both efficiency and effectiveness.

PBS EVALUATION AND ALTERNATIVES FOR IMPLEMENTATION

In evaluating the Priority Budgeting System (PBS), one must remember that because the system has not gone full cycle through legislative review and variance reporting, it is not appropriate to evaluate the impact of PBS on budget outcomes or the extent to which PBS methods have been used in practice. The concept of program planning and budgeting as outlined in H.B. 643 is still new to Montana and an extensive list of the pluses and minuses of the pilot presentations cannot be offered at this time.

However, in reviewing the initial development and implementation of PBS, several observations can be made. In retrospect, problems have been encountered in the following areas:

1. The process encompasses substantial amounts of bureaucratic, administrative detail. Agency personnel expressed the opinion that much of the informational demands (numerous detail forms) placed upon them would not enter into the budget decision. From an executive viewpoint, few budgetary decisions for the next biennium could be clearly attributed to the PBS approach.
2. Inasmuch as decision packages were developed at low levels of activity as prescribed by the PBS process, they were not suitable for publication in the budget (except in summary form). If they were included, the budget might have to be tripled or quadrupled in size to accommodate the PBS information. In addition, if the activity level at which decision packages were evaluated becomes the level at which appropriations are made - - the number of appropriations would also have to be multiplied.
3. Resistance to the PBS approach is inherent to the system in that the decision process becomes clearer and more open to scrutiny. As expected, initially some agencies viewed this openness with concern. However, once the basic concept was understood, most agencies cooperated fully and their budget presentations represent a total commitment to the process.
4. Much of the initial information requested under PBS and received by the budget office was poor to mediocre in quality. As a result, many of the forms had to be redone or new information developed. The major problem was due to a lack of understanding of the concepts and procedures involved in PBS budgeting. In addition, once the decision was made to proceed with a PBS format, there was limited time to train and indoctrinate key agency personnel and agencies had limited time to complete the forms. Finally, much of the information available to the agencies on their developed activity decision packages was available only at more aggregate levels, compounding the requirement for detailed information.
5. Another problem which surfaced is that agencies with mixed funding structures (federal and earmarked versus General Fund) were not scrutinized as closely, given the time frame for analysis. The major portion of analysis was devoted to general fund appropriations.

6. An additional problem was the lack of staff time to perform proper program analysis of the submitted decision packages. In many cases, PBS served to highlight program problems, issues and alternatives, but sufficient portions of time were not available for independent examination. For many programs, workload and effectiveness measures were lacking or the cause/effect and program impact was not well defined so that analysis could be accomplished. In several instances, analysis was limited strictly to input analysis of dollar costs and FTE's.

Developing a desirable and effective budgeting system is no easy task and our experience with PBS bears this out. But, in the initial development and implementation states of PBS, several beneficial points can be attributed to the process.

1. The PBS approach helped to eliminate unsupported opinion or emotional rhetoric used in the past to justify programs. Agencies were required to justify their expenditures based on identified outputs and effectiveness indicators - not strictly on a narrative presentation.
2. The process required a review of current as well as proposed program activities and solicited alternatives to program operation.
3. PBS brought together program planning, budget development and operational decision making.
4. In some instances, major reallocation of resources took place as less productive administrative costs were shifted into direct program delivery. For example, in the Wildlife Program, Department of Fish and Game, certain wildlife areas of low population densities and low public activity were identified as receiving an undeserved amount of attention. A redirection of activities to areas of immediate concern and to wild-life species in greater need of protection was accomplished.
5. The process provided the opportunity for program people to provide input into the budgetary construction process normally done entirely by centralized services personnel.

The Priority Budgeting System is a management - oriented system that combines planning, budgeting and operational decision making into a single process. It is a management tool that has the potential to bring about a measure of reform to budgetary processes if it is clearly understood that the real benefits will be long-term, costly and modest, rather than sudden and dramatic. It cannot be too strongly emphasized that the PBS system or any other zero-based budgeting system will not automatically reduce budgets. It still requires executive and legislative discipline.

PBS IMPLEMENTATION ALTERNATIVES

A critical stage in the process of introducing a new budgeting concept is that of implementation. The obituaries of other revolutionary budgeting ideas make it clear that failure could be attributable not so much to weaknesses in the system – on the contrary, many of the essential elements were practically sound – but rather to the manner in which the new budgetary ideas were introduced and implemented. Five principal alternatives exist which might be pursued in implementing the Priority Budgeting System (PBS):

1. Immediate and total implementation.
2. Phased implementation.
3. Selected implementation.
4. Recurring implementation.
5. Continuance of the present system with a modified approach emphasizing selected reforms.

Immediate Implementation

The immediate implementation of PBS for all state agencies is one method to achieve budgetary reform. Under a strategy of immediate implementation several advantages would be realized:

1. Agency disadvantage would be removed – All agencies would be on equal ground relative to converting to the new system.
2. More immediate realization of budget reform objectives – The objectives of PBS stand to be more immediately realized through total implementation than through the other methods.
3. Public interest in budget reform retained – Public interest and support should remain higher with immediate implementation.

Some disadvantages are:

1. Limited sharing of departmental budgeting experiences – Immediate implementation does not permit enough time for agencies with common problems to work together and cooperate in problem solving.
2. Restricts changes in course of action – With immediate implementation, the need may arise subsequently for significant alterations in budget format, etc.: opportunity for change is increased under a gradual or phased strategy.
3. Intensifies opposition – With immediate implementation, all criticism and opposition is focused on PBS at one time.

Other Consequences of Implementing PBS

Regardless of which approach is chosen, there are several consequences of implementing a priority budgeting system:

1. Even when a Priority Budgeting System has been established, decision makers are likely to concentrate on only a small number of issues and programs. There is a possibility that much of the information generated by PBS will be unused or extensively underutilized by decision makers because of political, economic or social reasons.
2. Implementation will not be easy because it demands time – a costly and scarce resource – not only on the part of budgetary personnel, but individual program managers and other associated personnel in complying with the requirements of a PBS approach. If a PBS approach is going to succeed, it must also have the acceptance of the “rank and file” administrators – program managers – and backing from top to bottom in each organization. There is also a significant need for training and technical assistance on the part of those people responsible for budget preparation and presentation.
3. The development of a PBS approach is contingent on developing sound measurements and measurement techniques. Individual managers may have problems in identifying appropriate program units, developing adequate data, determining minimum levels of effort, ranking packages and developing performance measurements. Essential to any system of measuring output and effectiveness is the requirement of subsequent evaluation. The accounting system or some kind of information system must be designed so that it can generate data by which the ultimate impact of budgetary decisions can be reviewed. It makes little sense to make initial budgetary allocations to activity classifications if the accounting system will generate data only on the basis of object classifications.
4. There will be a need with the implementation of PBS for additional personnel in the individual agencies. PBS or any kind of budgetary reform requires a different kind of administrative personnel than in the past. The PBS process requires a great deal of effective administration, communication, and training of managers for analysis. The very nature of PBS dictates more information, more analysis and more administrative machinery to present a viable working document from which to make valid decisions. These requirements in turn translate into increased costs for both the budget office and individual agencies.
5. There will be a need to change the language of the existing bill. For example, the establishment of an arbitrary 80% funding level is unrealistic. Perhaps the alternative funding levels should be restricted to being “less than current level” or the Governor or legislative finance committee could provide the figure based upon the financial condition of the state when the budget is developed. As written, the bill is too rigid and does not provide the needed flexibility for varying financial conditions.

Continuation of the Present Budgeting System

Every budget process has the potential for reviewing all programs from point zero — not just incremental requests. Even without a formalized priority or zero-based budgeting system, there are techniques that can be employed that will formalize the review of agency requests. The current Program - Planning - and Budgeting System and the zero-based concept are markedly similar. Both ZBB and PPBS require that budgetary decisions be made on the basis of programs or activities, rather than object-classifications. They both emphasize incremental changes in costs and benefits and both demand that benefits (outputs and effectiveness indicators) be quantified. ZZB and the approach used in PBS focus more on discrete units of both input and output and require the ranking in order of priority of those decision units. Bearing in mind the similarity of ZZB, PPBS and PBS, the alternative to continue the present system of budgeting and to emphasize some selected features of a PBS or ZZB approach remains a viable method of controlling governmental expenditures.

The trend in many states and the approach utilized in this year's budget presentation is to review budget requests based on the following criteria:

1. Analysis of the current base,
2. Analysis of expanded or modified services, and
3. Analysis of new services.

It has been the experience that concentrating on the review of statutory requirements, major increases and decreases for existing programs, new programs and capital expenditures and other areas where there appear to be problems has resulted in considerable payoff.

The question is raised concerning the ability to get people to think in terms of alternatives or to conduct a more thorough review of their existing programs than might be routinely undertaken. The approach of reorientating program managers can result in better budgeting.

This approach of indoctrinating program managers to justify their programs from zero, to consider alternatives and to priority rank requests for example, above the base is a viable alternative to implementing a full-fledged priority budgeting system. With emphasis on orientation of program managers and ongoing analysis, the same impact as PBS could result, but at less cost. This approach would include:

1. More statutory review of agency enabling legislation,
2. More program analysis to determine whether or not programs are accomplishing their objectives and whether the objectives are still needed,
3. Development of output and effectiveness indicators and corresponding emphasis on variance reporting at levels where data is readily available and can be measured,

4. More awareness of the need to consider alternatives and different funding levels, and
5. Allowance for the reallocation of funds from one approach to another and priority ranking all requests above the base.

The key to achieving the benefits of a PBS system utilizing the current budgetary process is to embody the concept of priority budgeting into budget requests, stressing the point that everything demands justification before dollars are provided. This concept, plus ongoing analysis permits a continuous review of management practices and performance as well as periodic recommendations for improvement or discontinuance.

